

# The Accrual Basis of Accounting and The Reasons for Adjusting Entries

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## Abstract

Accrual basis of accounting is an accounting recording technique, which is recorded when a transaction occurs even though cash has not been received. In recording using the accrual basis of course it will be more accurate, and by using the accrual basis of assets, liabilities and equity are easy to measure. Adjusting entries are made at the end of an accounting period after a trial balance is prepared to adjust the revenues and expenses for the period in which they occurred. Adjusting entries must involve two or more accounts and one of those accounts will be a balance sheet account and the other account will be an income statement account. You must calculate the amounts for the adjusting entries and designate which account will be debited and which will be credited. After completing the adjusting entries in all the appropriate accounts, you must enter them into your company's general ledger.

**Keywords:** Accrual Accounting, Adjusting entries, balance sheet account

## 1. INTRODUCTION

The accrual basis of accounting is the concept of recording revenues when earned and expenses as incurred. The use of this approach also impacts the balance sheet, where receivables or payables may be recorded even in the absence of an associated cash receipt or cash payment, respectively (Hua and Shang, 2021 and Zhang, 2022). The accrual basis of accounting is advocated under both Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS). Both of these accounting frameworks provide guidance regarding how to account for revenue and expense transactions in the absence of the cash receipts or payments that would trigger the recordation of a transaction under the cash basis of accounting (Zhang et al., 2022). Adjusting entries are required at the end of each fiscal period to align the revenues and expenses to the “right” period, in accord with the matching principle in accounting (Poljašević et al., 2021). In general, there are two types of adjusting journal entries: accruals and deferrals. Adjusting entries are booked before financial statements are released. The two main categories where adjustments arise are: Accruals: Revenues earned or expenses incurred that have not been previously recorded Deferrals: Receipts of assets or payments of cash in advance of revenue or expense recognition

## 2. LITERATURE REVIEW

Accrual accounting is an accounting methodology in which transactions are recognized as economic events that underlie recording, regardless of cash receipts and payments (Warren, Reeve, & Duchac, 2015). The implementation of accruals is very important as a government policy instrument in helping the financial crisis because it can provide more comprehensive information about financial conditions in terms of income, expenses, expenses, and liabilities (Guerra de Sousa et al, 2018)

Accounting Accrual events are approached in two type focus perspective, assets perspective and liability perspective. Accrual basis is different from the cash basis in terms of how assets and liability are reported and how revenues and expenses recognized (Khair et al., 2020). Accrual basis of accounting recognizes revenues when earned (a product is sold or a service has been performed). Expenses are recognized as incurred to produces revenues, whether or not cash has been paid out.

Accrual accounting performs better on analyzing how company has performed in some period wheter it reported in fiscal quarter or fiscal year (Haykal et al., 2020). Although accrual accounting gives measurably performances in terms of business economic events, in terms of business's cash flow, have difficult to provides clear information.

Providing a balance sheet, income statement and

changed shareholder's equity statement from users in separated cash flow can provide well informed options (Lubis et al., 2021). In determining the viability of a business in the short term, timely bill payments, cash flow statements are more considered. Although, in management decision making and accountability, recording in accounting numbers on a transaction is a mandatory approach to accrual accounting. As a result, accrual accounting numbers are more accurate than cash accounting numbers for decision-making scenarios. Depreciation costs charged with matching either the original purchase cost or the replacement cost over the life of the asset, form the core of accrual accounting. where the time shift in recording transactions and recognizing expenses is in the period of occurrence, not being paid. Our discussions of Accrual basis in accounting will emphasize internal reporting and related management concerns in many of the following sections.

### 3. METHODS

This study was designed by descriptive approach through the collection of previous literature about basis and implementation of accrual accounting approaches and giving examples about adjusting the entries to show how entities may attempt the principles set out reporting. This study will provide a theoretical overview The Accrual Basis of Accounting and The Reasons for Adjusting Entries.

This paper is set goals to help users acknowledge the reasons why and how to adjust entries of accrual accounting. More specifically, the Compendium provides approaches and examples to illustrate how entities may apply the principles set out in the Framework over financial reporting. A number of published articles has also been examined to get a view of the researchers in this area.

## 4. RESULT AND DISCUSSION

### 4.1 Result

Adjusting entries are a crucial part of the accounting process and are usually made on the last day of an accounting period. They are made so that financial statements reflect the revenues earned and expenses incurred during the accounting period.

Adjusting entries impact five main accounts.

#### 1) Accrued Revenues

Any service performed in one month but billed in the next month would have an adjusting entry

showing the revenue in the month you performed the service.

Making the adjusting entry by debiting accounts receivable and crediting service revenue.

#### 2) Accrued Expenses

Wages paid to an employee is a common accrued expense.

To make an adjusting entry for wages paid to an employee at the end of an accounting period, an adjusting journal entry will debit wages expense and credit wages payable.

#### 3) Unearned Revenues

Payments for goods to be delivered in the future or services to be performed is considered unearned revenue.

#### 4) Prepaid Expenses

Prepaid expenses refer to assets that are paid for and that are gradually used up during the accounting period. A common example of a prepaid expense is a company buying and paying for office supplies.

During the accounting period, the office supplies are used up and as they are used they become an expense. When office supplies are bought and used, an adjusting entry is made to debit office supply expenses and credit prepaid office supplies.

#### 5) Depreciation

Depreciation is the process of assigning a cost of an asset, such as a building or piece of equipment over the economic or serviceable life of that asset.

Adjusting entries for depreciation is a little bit different than with other accounts. A company has to consider accumulated depreciation.

Accumulated depreciation refers to the accumulated depreciation of a company's asset over the life of the company. On a company's balance sheet, accumulated depreciation is called a contra-asset account and it is used to track depreciation expenses.

In the contra-asset accounts, increases are recorded every month. Assets depreciate by some amount every month as soon as it is purchased. This is reflected in an adjusting entry as a debit to the depreciation expense and equipment and credit accumulated depreciation by the same amount.

### 4.2 Discussion

The application of account accruals through life case studies is an effective method to measure how accurate this method is. The entities involved also vary depending on the information, strategy, and scheme of use.

The purpose of accrual accounting adjustments is to get a more measurable calculation and picture of the company's financial condition. this method arises from the increasing complexity of business transactions and the need for more accurate financial information. Credit sales, and projects that provide long-term revenue streams affect the company's financial condition in the transaction process. Therefore, it is very relevant that the financial statements during the reporting period are the same as when the transaction occurred.

Various types of accrual accounts can be found in real-world implementations, the most common of which are payables, receivables, and taxes owed. by implementing accrual accounting, expenses, debts of a company on the balance sheet as accounts payable obligations and profit and loss statements. Accounts payable refers to debts that are incurred when the goods have been received before paying for them.

In using the accrual accounting method, companies that receive goods or services on credit must report their obligations no later than the date the goods are received. Expenses to be paid will be recorded as

trade payables under the current liabilities section of the balance sheet and as expenses on the income statement. In the general ledger, when bills are paid, the accounts payable account is debited, and the cash account is credited.

Although it requires more proper preparation and its relatively complex use, the use of accrual accounts makes it suitable to be adjusted in various conditions such as decision making or other company financial activities due to the results with more measurable calculations. As a result, many countries have implemented this method such as Australia, Brazil, and Portugal.

## 5. CONCLUSION

The accrual basis is an accounting basis in which economic transactions or accounting events are recognized, recorded and presented in financial statements based on interactions at the time the transactions occur, regardless of the time they are received or introduced. An adjusting entry is a journal that is made in the process of recording changes in the balance in an account that reflects the actual amount.

Type Of Adjustment	Accounts Before Adjustment	Adjusting Entry
Prepaid expenses	Assets overstated Expenses understated	Dr. Expenses Cr. Assets or Contra Assets
Unearned revenues	Liabilities overstated Revenues understated	Dr. Liabilities Cr. Revenues
Accrued revenues	Assets understated Revenues understated	Dr. Assets Cr. Revenues
Accrued expenses	Expenses understated Liabilities understated	Dr. Expenses Cr. Liabilities

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